

**CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY**

FOR

**MANAGER DEVELOPMENT PROGRAM I and II (MDP) POLICY AND MANAGER
TRANSITION POLICY**

~~October 12, 2007~~ November 13, 2007

*This Policy is effective immediately upon adoption and supersedes all previous ~~manager~~
~~Manager development~~ ~~Development program~~ ~~Program~~ (MDP) ~~manager graduation and~~
~~Mmanager d~~ ~~Development p~~ ~~Program~~ (MDP) ~~Mmanager~~ transition policies.*

I. PURPOSE

The CalPERS Total Fund Statement of Investment Policy, adopted by the CalPERS Investment Committee ("Committee"), sets forth CalPERS' overarching investment purposes and objectives with respect to all its investment programs.

This document sets forth the investment policy ("the Policy") for the Manager Development Program (MDP) I and II ("Program") and the transition of managers from MDP, Global Equity with respect to the transition of firms moving from CalPERS' Manager Development Program I and II (MDP) into a direct contractual relationship with CalPERS for the management of CalPERS' assets.

The design of this Policy ensures that investors, managers, consultants, and other participants selected by the California Public Employees' Retirement System ("CalPERS") take prudent and careful action while managing the Program. Additionally, use of this Policy assures sufficient flexibility in managing investment risks and returns associated with these segments of the global capital markets.

INTRODUCTION

II. STRATEGIC OBJECTIVE

Under its MDP, CalPERS provides venture capital and investment assets to small and emerging investment management firms in exchange for an equity stake in those firms. The returns from the venture capital investments augment the returns earned on the assets managed. The MDP is structured through limited liability company agreements for both venture and investment assets.

This policy permits CalPERS to contract directly with MDP firms that meet specified criteria. The Program is managed to accomplish the following:

A. Diversify CalPERS ~~the system's~~ overall eEquity pProgram;

~~by complementing the Passive Domestic Equity Program;~~

B. Enhance the expected return of CalPERS~~the System's~~ investment program; and

C. Hedge against active member (pre-retirement) liabilities; and

D. ~~Consider solely the interests of the System's participants and their beneficiaries in accordance with California State Law. (This language is now found in the Total Fund Statement of Investment Policy)~~

III. **RESPONSIBILITIES AND DELEGATIONS**

A. ~~The **System's Investment Committee** ("the Investment Committee") is responsible for approving and amending the Policy. The Investment Committee delegates the responsibility for administering the MDP and the externally managed portion of the System to the Staff through the Delegations of Authority (Delegation Nos. 89-13 and 06-03-INV).~~

AB. CalPERS Investment Staff ("Staff") is responsible for the following:

The System's Investment Staff ("the Staff") duties include, but are not limited to, the following:

1. ~~Developing and recommending the Policy to the Investment Committee;~~

2. ~~Developing and maintaining a procedures manual, subject to periodic reviews and updates, outlining Staff operational procedures to be used in implementing this Policy;~~

3. ~~Implementing and adhering to the Policy;~~

4. ~~Evaluating MDP firms for possible transition under this policy;~~

15. Taking action with respect to the MDP firms retained to implement the Program such as making changes in the manager's investment management guidelines;

26. Reporting to the Investment Committee, as needed, about the performance of the Program. The Staff shall report concerns, problems, material changes, and all violations of Guidelines and Policies immediately, and in writing, to the Investment Committee. These Reports made by the Staff to the Investment Committee shall include explanations of the violations and appropriate recommendations for corrective action; and,

347. Evaluating MDP firms for possible transition under this policy, including ~~Providing additional due diligence on potential firm transition candidates to determine the appropriateness for inclusion of potential transition candidates~~ in other CalPERS investment programs.

BG. MDP Partners shall be responsible for all aspects of compliance with their investment charter, which that shall includes the following duties:

1. Sourcing potential MDP firms for investment and providing due diligence evaluation for consideration by CalPERS;
2. Recommending the allocation of monies to the MDP firms that have been selected. However, they are not responsible for determining any MDP firm's transition to other CalPERS investment programs;
3. Monitoring the MDP firms and providing input and communication to the CalPERS Staff regarding the investment and business performance of these firms;
4. Providing business management and administrative advice and support in an effort to develop the MDP firms in which investments have been made; and,
5. Cooperating fully with the CalPERS Staff, Custodian and General Pension Consultant concerning requests for information.

DC. **MDP firms** are responsible for all aspects of portfolio management as set forth in their respective contracts with CalPERS ~~the System~~ and shall fulfill the following duties:

1. ~~Communicate~~ing with the MDP Partner and Staff as needed regarding investment strategy and investment results. The MDP firms are expected to monitor, analyze, and evaluate performance relative to the agreed upon benchmark; and
2. ~~Cooperate~~ing fully with CalPERS' ~~the Staff, the System's~~ Custodian and the General Pension Consultant concerning requests for information.

ED. The **General Pension Consultant** ~~shall be~~is responsible for ~~independently~~ monitoring and evaluating the MDP firms and for reporting recommendations, if any, directly to the ~~Investment Committee~~ on a quarterly basis, in accordance with the terms of its contract.

IV. PERFORMANCE OBJECTIVE AND BENCHMARKS

The Program is expected to outperform its custom weighted average benchmark. Within the Program, Managers, or portfolios, or both, are expected to achieve performance objectives as stated in their investment management guidelines.

V. INVESTMENT APPROACHES AND PARAMETERS

A. Approaches

1. MDP strategies shall be identified based upon their ability to add value above a specific style-specific benchmark on a risk-adjusted basis. The Dynamic Completion Fund will be used to attempt to neutralize any style bias of U.S. equity strategies.
2. The Program shall be implemented through the retention of external managers. External manager selection shall occur in accordance with Section V.B. of this Policy.
3. CalPERS shall continually review the viability of the Program, conducting a formal review annually.

B. External Manager Selection

CalPERS shall retain managers that have recognized expertise in the analysis and selection of U.S. or, non U.S. equity or-and fixed-income securities, or approved derivatives, or other public markets strategies approved by the Committee for external management and not specifically restricted by the Committee from inclusion in the Program. Emerging hedge funds, and funds of emerging hedge funds, are excluded from the Program. The selected managers shall be registered, or appropriately exempt from registration, with the Securities and Exchange Commission.

C. Investment Parameters

The Managers shall operate under a set of specific guidelines that outlines their investment philosophies and approaches, representative portfolio characteristics, permissible and restricted securities and procedures, benchmark and performance objectives.

Implementation of this Program shall comply at all times with CalPERS' applicable investment policies including, but not limited to, the following:

1. Statement of Investment Policy for Derivatives – External Money Managers';
2. Proxy voting policies;

3. Manager Monitoring – External Managed Policy; and

4. Manager-specific investment management guidelines.

VI.IV. MANAGER EVALUATION AND TRANSITION

CalPERS' MDP permits investment in small and emerging investment management firms with less than \$2 billion under management, whose primary investment focus is institutional clients. ~~in public equity and high yield fixed income markets, and whose primary market focus is institutional clients. The MDP II program may also include emerging hedge fund-of-funds.~~ Permitted strategies are those that the Investment Committee has approved for use in CalPERS' other externally managed public equity and fixed income programs, excluding emerging hedge funds and funds of emerging hedge funds. Any new strategies the Investment Committee may approve for public markets external management at a future date are automatically permitted for the Program ~~are included by the Investment Committee, unless specifically prohibited by the Committee.~~

The MDP I is closed to new investments and the MDP II program will select firms opportunistically. Firms in the MDP may be transitioned into a direct contract with CalPERS for the management of CalPERS' System ~~assets~~ if all of the following conditions are met, and contingent upon successful negotiation of fees:

- A. The MDP firm has been successful with respect to any of the following: attracting significant assets from investors other than CalPERS; demonstrating profitability without additional assets from CalPERS; or attracting other corporate or public pension fund or endowment/foundation clients who have completed successful due diligence on the manager, regardless of the size of the assets awarded;
- B. The MDP firm has competitive risk-adjusted performance;
- C. Additional assets allocated to the MDP firm's investment approach and style will enhance CalPERS' overall manager structure in the relevant asset class; and,
- D. The ~~Investment Committee~~ approves an exemption from competitive bidding process resolution for the firm based on a best business practice decision ~~decision~~ (CalPERS Board of Administration Resolution No. 92-04B-2).

CalPERS ~~The System's Investment Staff~~ will evaluate and recommend MDP firms to the ~~Investment Committee~~ for transition based on the above criteria. The

General Pension Consultant will provide an opinion letter to staff on all recommended MDP transitions.

VII. CALCULATIONS AND COMPUTATIONS

Investors, managers, consultants, and other participants selected by CalPERS shall make all calculations and computations on a market value basis as recorded by CalPERS' Custodian.

VIII. GLOSSARY OF TERMS

~~Definitions for k~~Key words used in this policy are defined ~~located in the Equity Glossary of Terms which is included in CalPERS' the System's Master Glossary of Terms.~~

Manager Development Program (MDP) Manager Graduation

Approved by the Policy Subcommittee: June 13, 2003

Adopted by the Investment Committee: August 18, 2003

Revised by the Policy Subcommittee: December 10, 2004

Adopted by the Investment Committee: February 14, 2005

Name changed to Manager Development Program I and II (MDP) Manager Transition

Revised by the Policy Subcommittee: February 20, 2007

Adopted by the Investment Committee: March 12, 2007

Name changed to Manager Development I and II (MDP) Policy and Manager Transition Policy

Revised by the Policy Subcommittee: October 12, 2007

Approved by the Investment Committee: November 13, 2007

Asset Class Glossary: Equities
Policy: Manager Development Program I and II (MDP) Policy and Manager
Transition Policy
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Custodian

A bank or other financial institution that provides custody of stock certificates and other assets of an institutional investor.

~~Emerging Hedge Fund of Funds~~

~~An investment fund which is comprised of hedge funds. A hedge fund is an actively managed portfolio that may utilize long and short positions, derivatives, and leverage. A fund-of-fund allows an investor to invest in more than one hedge fund via a single investment fund rather than having to invest in individual hedge funds separately. The term "emerging" applies solely at the fund-of-funds level and not to the underlying hedge funds within the fund-of-funds. This definition applies within the context of the MDP Transition Policy and MDP II program.~~

Limited Liability Company

An alternative structure to a Limited Partnership. It is often described as a hybrid between a corporation and a partnership because it offers limited liability like a corporation and single taxation on income like a partnership.

MDP Firm

An investment management firm managing CalPERS' assets as part of CalPERS' MDP program.

MDP Partner

A managing member of a CalPERS MDP limited liability company.

Risk Adjusted Performance

Performance results evaluated on the amount of risk taken to generate the results, generally by evaluating the standard deviation of the returns generated.

Transition

The process for which an MDP firm is moved out of the MDP programs and into one of CalPERS' other investment programs via a direct contract. This definition applies solely within the context of the MDP Transition Policy.

Venture Capital

The financing of rapidly-growing companies that do not have access to public equity or debt financing. Early-stage venture capital may involve financing a company during its initial years when assets may be limited and when there may be no revenues. Late-stage venture, sometimes referred to as growth equity or expansion capital, may involve financing a company that has established products or services and revenues.